FIVE YEAR PLAN

DISCOUNT BRANDS

DISCOUNT BRANDS

The discount category's profitability improved in 1991 as a result of industry pricing actions. However, the category's volume growth rate slowed from 28.7% in 1990 to 25.5% in 1991. The continued compression of branded discount prices in 1992 and 1993 will cause the category to experience sharp reductions in growth in the first two years of the plan period. Compounded annual volume growth in the discount category during the planning period is projected at 5.8% resulting in an essentially flat performance in 1996 (1.3% over 1995).

For Philip Morris to achieve its volume and share objectives, PM USA discount brands will need to significantly outperform the category overall, achieving a compounded annual growth rate of 9.1%. Most important, PM USA discount brands must accomplish this level of growth by sourcing volume from competitors. Specifically, PM USA must capture about one half of the category's volume growth while simultaneously not accelerating our share of full margin volume erosion beyond 17%.

Our strategies to accomplish these objectives are as follows:

1. A two Brand Focus (Cambridge and Bristol) designed to provide an underlying unit base within our discount portfolio augmented by private labels and carefully targeted niche products (Alpine) capable of delivering incremental volume.

2. Creation of a pricing structure that continues to increase the profitability of PM discount products.

3. Tactical use of price reduction designed to escalate price subsidy levels in PM full margin - low risk environments, which will force competitors to defend discount products.

4. Maintenance of a meet competition defensive posture in mainstream (full margin - high risk) environments.

5. Aggressive pursuit of private label partnerships among key customers and a reduction in the overall mass of discount brand display. We will, at the same time, defend against broad market black & white (non private label) initiatives with price subsidy on branded products.

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6. The introduction of niche products and utilization of programs against competitive full margin products i.e. menthol, non-filter and lowest tar where PM risk of full margin cannibalization is low.

7. When and where necessary, assume the risk of cannibalization by launching discount products into segments, traditionally PM full margin strongholds, to defend against competitive initiatives i.e. slim circumference and 100mm.

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DISCOUNT BRANDS

Industry pricing actions in 1991, coupled with greater than anticipated unit shortfalls among our competitors, has resulted in extremely aggressive price reduction activity. Further, the predictability of PM/USA's meet competitive strategy has enabled competitors' to undercut our discount brands' net retail prices during periodic unit drives.

Issue:

Philip Morris's strategy of universally responding to competition has become predictable and resulted in our discount products being price disadvantaged on a regular basis.

Strategy:

While generally employing a defensive/meet competitive strategy, PM USA will:

- Lead in the escalation of price subsidy levels in outlets identified as full margin/low risk environments.
- PM USA will periodically lead in price reduction in mainstream outlets to eliminate predictability -- timing such periods against excessive competitive retail inventories.

ACTION PLAN

1992-1993

With the exception of the circumstances listed below, PM/USA will generally meet competitive price subsidy levels:

- In 3,000 retail outlets (accounting for 20% of the discount category's volume) Cambridge and Bristol couponing incidence will be increased to 90% with values of $1.00 above prevailing competitive levels.
- In carefully identified carton outlets (D county), Cambridge and Bristol will increase couponing incidence to 90% with values of $1.00 greater than prevailing competitive levels.
- PM USA will respond to excessive competitive discount brand retail inventories, by exceeding the competitive coupon value on such inventory by $1.00 on PM discount brands.
- PM USA will pursue Bristol Lowest and non filter aggressive price reduction in developed competitive markets.

1994 - 1996

- Price subsidy levels will be stabilized at values sufficient to ensure a net price gap between premium brands and lowest price branded discount products of no greater than 25% of full margin net retail prices.

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DISCOUNT BRANDS

Industry pricing actions have created a low price vacuum at retail. The low manufacturer list price and rebate structure creating substantially high levels of wholesale and retail trade profitability in private label and black & whites has resulted in explosive growth in this segment in 1991. The growth of FVB at the expense of Branded Discount Products within PM USA's portfolio hinders our ability to meet profitability objectives. Nonetheless, participation in these trade driven segments is required to protect and to grow our share in the discount category.

Issue:

The absence of profitability in this segment requires that we integrate merchandising values commonly associated with private label partnerships as opposed to broad market black & white initiatives that solely deliver volume.

Strategy:

A comprehensive sales and marketing strategy that integrates pricing, merchandising, and trade rebates is planned. PM USA needs to achieve a low end performance that optimizes our overall position at retail. Our strategy necessitates:

- Construction of a PM/USA pricing structure to qualifying trade customers that incents private labels as opposed to a black & white approach.
- Reduction of the minimum required annual performance for production of private labels.
- Creation of a PM/USA pricing structure and customer credit terms that allows for shipment frequency options reducing pressure on manufacturing capacity requirements for private label production.
- Retention of sufficient Basic volume in outlets that do not qualify for private label partnership to ensure that PM/USA meets its overall discount brand volume objective.
- The introduction of profitability into FVB.

ACTION PLAN

1992 - 1993

- Differentiate the pricing and rebate structures of Basic and private labels to incent private label.
- Integrate private label partnership with full margin merchandising and discount category presence at retail.
- Solicit private label partnerships among retail chains with projected private label volumes in excess of 100mm units per year.
- Convert wholesale and retail customers selling in excess of 100mm units of Basic per year to PM private label partnerships.
- Freeze Basic DME and rebate levels thereby introducing profitability into the franchise.
- Construct a matrix of shipment and production criteria linked to payment terms to allow for greater private label participation.
- Standardize private label graphics to allow uniqueness within widely separated geographies while simultaneously limiting packaging alternatives at the point of manufacture.

1994 - 1996

- Increase PM USA's private label/black & white profitability.
- Reduce PM USA's reliance on non private label/black & whites i.e., Basic, to under three billion units enabling PM USA to carry discount volume in branded products and private labels delivering merchandising values to PM Brands overall.

DISCOUNT BRANDS

Segmentation and media support have been introduced into the category with recent launches. Price is no longer the sole USP among discount brands. Especially among recent entries, i.e., Misty, Bull Durham and Style, brand equities beyond price are advantageous as subsidy levels blur differentiation among the universe of discount brands.

Issue:

Philip Morris USA must create equities and values on behalf of its branded discount products beyond price alone to achieve differentiation as the category becomes more cluttered with new image based entries.

Strategy:

A three point strategy is planned:

- While not changing the fundamental focus on price in Cambridge and Bristol's consumer communications, both brands' campaigns will evolve to achieve two objectives; First, to differentiate Cambridge and Bristol and second, to subtlety introduce Brand equities beyond price.
- New entries by PM USA into the discount segment will, in packaging, positioning and communication, place higher emphasis on non-price related equities.
- Consumer communication on behalf of Alpine, Bristol Lowest, and Cambridge Lowest will be single-mindedly focused on competitive targets. Taste claims and comparative advertising will be increasingly used on behalf of these brands.

ACTION PLAN

1992 - 1993

- A new Cambridge campaign with a "smart shopper" emphasis will be created and launched.
- Bristol's "Price Fighter" campaign and boxing glove mnemonic will evolve in both advertising and POS to include other equities, i.e. flavor knockout, value champion, etc.
- Cambridge Lowest and Bristol Lowest will continue to be featured in pulsed media executions with explicit Now/Carlton comparison.
- Alpine's campaign in 1992 will be modified to achieve a more intrusive presence in retail executions and be more explicit in its communication to Salem smokers.

- PM USA will introduce a new, sub-generic free standing menthol targeting younger (18 - 30), urban smokers utilizing an image based campaign with price communicated as a secondary benefit.

1994 -1996

- PM USA will significantly shift resources away from price subsidy to sustainable campaigns communicated in both media and point of sale executions sufficient to allow a modest carton price disadvantage against the lowest priced branded product without suffering share erosion.

DISCOUNT BRANDS

The growth of the black & white segment eroding PM USA's discount brands' aggregate profitability coupled with escalating levels of price subsidy will restrict our ability to simultaneously meet profit contribution objectives, maintain support on four national brands, and introduce new discount products where warranted.

Issue:

The unit contribution of Bristol, Cambridge and FVB require spending levels adequate to ensure net retail price competitiveness and will inevitably drain Discount Brand resources from other initiatives. However, these three franchises alone will not provide sufficient volume for PM/USA to meet objectives during the planning period.

Strategy:

The discount brand portfolio of PM/USA will be restructured as follows:

- Resources supporting Bucks will be reduced to allow spending on other discount brand initiatives to be increased.
- Funding of Alpine initiatives during the planning period will be limited to 30 key Salem geographies in offensive programs solely designed to source incremental volume.
- In key markets, PM USA will launch a second free standing menthol into the discount category against young, urban smokers -- rounding out our menthol alternatives to source incremental volume.
- In key markets, PM/USA will launch a free standing 100mm full circumference and slim circumference discount product to capture disenfranchised Benson & Hedges and Virginia Slims smokers.

ACTION PLAN

1992 - 1993

- Bucks spending and marketing programs will be front loaded in 1992 to achieve high levels of trial and maintenance of retail distribution.
- Bucks support will be withdrawn in the 2nd half of 1992.
- Monterey 100's full circumference and slims will be launched at the sub-generic price point in California in 1992 and gradually expanded where necessary in 1993.

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- Alpine will continue to investment spend in 1992 becoming more explicit in its communication against a Salem audience with resource support in 1993 and beyond being limited to offensive programs in 30 select geographies.

- Bristol and Cambridge promotional and media support, will as required, be converted into price subsidy to ensure competitiveness at retail.

<u>1994 - 1996</u>

- Bristol and Cambridge price subsidy levels will be stabilized and volume will erode slowly.

- Support against Monterey, Alpine and a new free standing menthol will be increased as we source incremental units.

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CAMBRIDGE

POSITIONING

- Brand of choice for price sensitive consumers.

GEOGRAPHY

- National Scope - With greatest emphasis and resource support in highly developed discount geographies.

TRADE CLASS

Carton Outlets

- Increase promotion penetration in chains.
- Maximize volume in mega volume outlets.

Pack Outlets

- Generate trial and purchase continuity.
- Maintain visibility.

STRATEGIC APPROACH

- Maintain price competitiveness.
- Improve retail presence.
- Heavy-up marketing efforts in key geographies and trade classes.
- Gain retail presence and drive volume with value added retail programs with modest media support communicating a smart shopper position.

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BRISTOL

POSITIONING

- A quality product at the lowest branded price point in the industry.

GEOGRAPHY

- Achieve broad geographic distribution while focusing retail support and marketing resources in a limited retail environment in which off-rack display and signage can be secured on a regular basis.

DEMOGRAPHICS

Key Audience
- 35+ years of age
- Lower income and education
- Predominantly white
- C&D counties

TRADE CLASS

Carton Outlets

- Utilize off-rack display and traditional packaged goods deals to maintain momentum.

Pack Outlets

- Secondary in importance to carton outlets, our objective is to ensure Bristol availability with limited promotional support to provide trial.

STRATEGIC APPROACH

- Generally utilize a defensive price subsidy approach in mainstream outlets.
- On a targeted basis in full margin low risk environments, Bristol will offensively price subsidize exceeding competing values by $1.00.
- Gradually expand distribution where the opportunity for sub-generic performance exists.
- Utilize standard package goods "deals" to obtain off-rack display as well as find a permanent merchandising position for Bristol.

- Key to maintain growth:

1. Provide Field Sales Force tools such as co-op advertising, P.O.S. and displays to continuously work the Brand outside PM-USA's promotion schedule.

2. Aggressive promotion that adds value for the consumer and retailer.

3. Utilize "boxing glove" mneumonic in consumer communication, primarily at point of sale, referencing price, value and quality.

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ALPINE

POSITIONING

- Legitimate refreshing menthol alternative for Salem/menthol smokers at a lower price.

GEOGRAPHY

Alpine will continue to develop regionally with regions 2, 3, 4 contributing over 72% of Alpine's volume. Heavy-up support in highly developed menthol and Salem markets.

DEMOGRAPHICS

Core Audience - B&C counties, slight female skew, 35+ years.
Key Audience - Full margin, Salem/menthol smokers.

TRADE CLASS

Carton Outlets

- Achieve trial and prominent merchandising and promotion to access menthol's traditionally strong pack performance.

Pack Outlets

- Correct merchandising and distribution shortfalls to provide Alpine sufficient availability in carton outlets to support loyal buyers.

STRATEGIC APPROACH

- Focus support and spending in strong Salem/menthol markets.
- Achieve off-rack display
- Cause RJR to spend defensively to protect Salem franchise.
- Increasingly utilize explicit references and comparative claims against a Salem smoker audience.